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BY THE U.S. GENERAL ACCOUNTING OFFICE

Report To The Secretary Of Defense

Leased Military Housing Costs In Europe Can Be Reduced By Improving Acquisition Practices And Using Purchase Contracts

The Congress has expressed a strong and continuing interest in reducing the high costs of leased housing overseas for U.S. military families. The Department of Defense (DOD) and the military services have not been successful in containing the growth of leased housing in Europe.

GAO found various opportunities to improve the services' acquisition practices in awarding and administering family housing leases that would increase competition and offer opportunity to reduce leasing costs in Europe. Also, GAO believes that granting the services authority to acquire needed housing through installment purchase contracts is an alternative means of reversing the trend toward increased leasing.

GAO makes recommendations to the Secretary of Defense to strengthen the management of the military services' leasing programs. GAO also suggests legislative changes which would authorize acquisition of housing through purchase contracts when economically justified.

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JULY 24, 1985

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UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

NATIONAL SECURITY AND
INTERNATIONAL AFFAIRS DIVISION

B-202121

The Honorable Caspar W. Weinberger
The Secretary of Defense

Dear Mr. Secretary:

This report discusses weaknesses and inconsistencies in the military services' lease acquisition practices for family housing in Europe and recommends actions to improve these practices. We also recommend that the Department of Defense seek legal authority to acquire needed housing through installment purchase contracts when economically justified.

This report contains recommendations to you on pages 14 and 29. As you know, 31 U.S.C. 720 requires the head of a federal agency to submit a written statement of actions taken on our recommendations to the House Committee on Government Operations and the Senate Committee on Governmental Affairs not later than 60 days after the date of the report and to the House and Senate Committees on Appropriations with the agency's first request for appropriations made more than 60 days after the date of the report. We would appreciate receiving copies of these statements.

The report also points out that the Navy's use of rental escalation clauses providing for indeterminable or indefinite amounts of rental in some lease agreements violate the Anti-Deficiency Act. In this regard, 31 U.S.C. 1351 requires the head of a federal agency to report immediately to the President and the Congress all relevant facts and a statement of actions taken concerning such violations.

In addition to the above committees, we are sending copies of this report to the Chairmen, House and Senate Committees on Armed Services; the Director, Office of Management and Budget; and the Secretaries of the Army, Navy, and Air Force.

Sincerely yours,

Frank C Conahan

Frank C. Conahan
Director

GENERAL ACCOUNTING OFFICE
REPORT TO THE SECRETARY
OF DEFENSE

LEASED MILITARY HOUSING COSTS IN EUROPE CAN BE REDUCED BY IMPROVING ACQUISITION PRACTICES AND USING PURCHASE CONTRACTS

D I G E S T

The primary goal of the Department of Defense (DOD) family housing program is to assure that its personnel and their families have adequate, well maintained housing. DOD's policy is to rely principally on communities near military installations as the source of family housing. In Europe, however, the shortage of adequate local housing with acceptable DOD standards of construction and features has required DOD to provide much of the needed housing through leasing construction agreements.

Under the agreements, a contractor agrees to finance and construct the housing and DOD agrees to lease it for military families. These agreements usually cover a period of 5 to 10 years and generally limit lessors' financial risks by structuring the rent to allow the recoupment of all, or a substantial portion, of the housing projects' costs during the terms of the leases. (See pp. 1 to 3.)

The rapid growth and high cost of leasing have caused congressional concern in recent years. For example, in fiscal year 1973, the DOD leasing ceiling was about 4,500 foreign housing units. By fiscal year 1983, the ceiling, which is now congressionally imposed, had increased by over 500 percent to 29,000 units. At the end of fiscal year 1983, the services had leased about 17,800 units. (See pp. 1 to 3.)

Because of concern over the leasing program growth, the following congressional actions have been taken:

--Direction that economic analyses be made to evaluate the comparative cost of new lease proposals with other alternatives for furnishing needed housing.

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--Instruction that buy-out provisions be included in all new leasing construction agreements (where annual unit costs exceed $12,000) enabling the United States to buy the leased housing during or at the end of the lease period.

--Increased appropriation of military construction funds to build needed housing instead of leasing. (See pp. 1, 19, and 27.)

GAO made this review to evaluate DOD's and the military services' progress in reducing the high cost of leasing in Europe. GAO focused on those aspects of the family housing program associated with the procedures and practices for awarding and administering leases. (See p. 4.)

GAO identified several opportunities to improve the services' acquisition practices in awarding and administering leases that would increase competition and offer opportunity to reduce the high cost of leasing. Also, GAO believes that an alternative funding mechanism for the acquisition of family housing exists that would reverse the trend toward increased leasing and offer financial benefits to the United States. (See pp. 6 and 18.)

IMPROVEMENTS NEEDED IN AWARDING AND ADMINISTERING LEASES

By law, the military services must comply with certain limitations on their authority to lease foreign family housing. For example, they must submit reports to appropriate congressional committees for proposed leases having average estimated annual rents of over $250,000. (See pp. 2 and 6.)

DOD has issued limited guidance to the services on the congressional reporting requirement. However, it has not issued guidance on or required the services to develop formal and uniform acquisition policies and procedures for lease awards.

Because DOD guidance was limited, GAO found that the services' major commands responsible for

leasing housing in Europe have developed different acquisition procedures and practices for awarding and administering leases.

The Navy's lease agreements in Italy included clauses for the annual escalation of the net rental (rental excluding cost of maintenance, operation, and utilities) which violated the Anti-Deficiency Act by obligating the United States to pay indeterminable or indefinite amounts of rental that could exceed the statutorily authorized maximum under 10 U.S.C. 2828(e).

Services' practices in awarding leases were inconsistent with those applying to supplies and services established to ensure the United States obtains the best contract agreements at a reasonable cost. Such practices included obtaining limited competition on lease awards, not adequately considering all lease offers, and not preparing cost estimates or obtaining real estate appraisals when negotiating prices in lease awards.

The services have different interpretations of congressional committee reporting requirements for lease agreements whose average estimated annual rental exceeds $250,000. The Navy submitted reports on groups of leases involving the same lessor when the rental exceeded the $250,000 while the Air Force did not. In addition, the Navy exercised renewal options for additional lease periods exceeding the limitation without congressional reporting. The Army's submission of reports was not based on the number of housing units in proposed leases, but on the number of units needed to eliminate a current military family housing shortage in a community so as to prevent any possibility of avoiding congressional reporting requirements. (See pp. 6 to 13.)

GAO believes that DOD should (1) issue uniform guidance on lease acquisition policies and procedures reflecting those acquisition standards applicable to supplies and services and (2) establish specific reporting criteria to assure compliance with the congressional committee

notification requirements. Uniform guidance should help ensure that the services' commands will consistently follow leasing practices that encourage competition, award leases to the best advantage of the United States, and comply fully with congressional reporting requirements. (See p. 14.)

ALTERNATIVES FOR REDUCING LONG-TERM LEASE COSTS

The services reported future 5-year family housing shortages totaling over 35,000 units in their most recent surveys of local housing markets in Europe. For fiscal years 1982 through 1984, the Congress authorized funding for construction of over 2,100 family housing units in Europe. The services were planning to request funds to finance the construction of over 9,400 units in Europe in fiscal years 1985 through 1989. (See pp. 1, 2, and 18.)

Because of budgetary constraints and the limited resources available for military construction of family housing, DOD's leasing program is likely to remain an important method of providing this housing in Europe. Leasing has a short-term budgetary advantage because the impact is spread over several budget years, whereas the impact for construction is concentrated in the current budget year. (See p. 18.)

An alternative recently used to some extent by the services is the inclusion of buy-out provisions in lease construction agreements providing the United States an opportunity to buy the housing during or at the end of the lease period. However, the services have different interpretations on the legal authority to enter into leases with these provisions and the best method to negotiate and structure the provisions. In addition, even if the services would exercise the buy-out provisions, they have not obtained assurances from all host country governments that the United States would be allowed to own or occupy the housing rent free under the international agreements between the host country and the United States. (See pp. 20 to 25 and 28.)

GAO believes that another approach offering opportunities to reduce long-term leased housing costs would be to grant the services legislative authority to enter into purchase contract arrangements for foreign family housing. Purchase contracting would enable the services to buy family housing without the need for large single-year appropriations for construction.

The services would enter into agreements with contractors for the construction and financing of family housing. They would make installment payments to the contractors for interest and amortization of the project's costs and profit. At the end of the contract period, title to the housing would vest with the United States. If the United States is precluded from owning property in the foreign country, title to the housing would vest with the host country in return for rent-free occupancy by military families. (See pp. 25 to 28.)

Although installment purchase contracts offer certain benefits that make them a useful alternative to leasing, they should be used only when they are economically beneficial to the United States. If the services are granted purchase contracting authority, they should prepare economic analyses before entering into purchase contract arrangements. These analyses should evaluate the comparative cost of purchase contracting with leasing, leasing with buy-out provisions, and direct appropriation of construction funds. The results could be provided to the appropriate congressional committees considering the services' requests for approval of family housing acquisitions. (See p. 27.)

RECOMMENDATIONS

To ensure that the military services follow consistent leasing procedures and practices and comply with congressional committee lease acquisition reporting requirements, GAO recommends that the Secretary of Defense direct the services to jointly develop and issue guidance on uniform policies and procedures for acquiring foreign leased family housing and for complying with the congressional committee reporting requirements for lease awards. This guidance should:

--Be consistent with those acquisition principles for advertising, evaluating, and negotiating contained in DOD regulations for other types of procurement.

--Require the services to provide, in leases having escalation of net rental clauses, that rental payments will not exceed the amount of appropriations available at the time payments are due or the statutory limit established for such year under 10 U.S.C. 2828(e) and that nothing in the lease can be considered as implying the Congress would, at a later date, appropriate sufficient funds to meet deficiencies.

--Include congressional committee reporting requirements for lease awards on groups of leases with the same lessor and renewals of existing leases.

GAO further recommends that the Secretary of Defense direct the Navy to seek amendment to the Italian leases and any others that have been awarded containing provisions on escalation of rental in indefinite or indeterminate amounts. The leases should include clauses stating that rental payments will not exceed the amount of appropriations available at the time payments are due or the statutory limit established for such year under 10 U.S.C. 2828(e) and that nothing in the lease can be considered as implying the Congress would, at a later date, appropriate sufficient funds to meet deficiencies. (See pp. 14 and 15.)

To resolve the military services' concerns over the legal propriety of buy-out provisions, GAO recommends that the Secretary of Defense evaluate and propose legislation to the Congress on the type of buy-out provisions that should be permitted in foreign leases.

To provide the military services with another alternative method of acquiring needed housing in Europe, GAO recommends that the Secretary of Defense propose to the Congress specific legislation granting the military services authority to use purchase contracting, when appropriate.

The report contains other recommendations to the Secretary of Defense concerning the use of

purchase contracts and buy-out provisions. (See p. 29.)

AGENCY COMMENTS AND GAO'S EVALUATION

In its comments on a draft of this report, DOD agreed with most of GAO's findings and described specific actions it will take to implement all of the recommendations. In some instances DOD provided updating or clarifying information, which has been included in the report, where appropriate. (See pp. 15 and 30.)

DOD disagreed with GAO's conclusion that the Navy's use of rental escalation clauses in lease agreements violates the Anti-Deficiency Act. DOD stated that with respect to leases containing the clauses in Italy, a previous Comptroller General decision appeared to not object to the clauses. DOD also stated that 10 U.S.C. 2828 is silent on the dollar amount of the maximum statutory expenditure limitation and, as a result, the leases would be exempt from the Anti-Deficiency Act prohibitions. GAO continues to believe that, absent the GAO recommended provisions in the lease agreements, the Navy's lease agreements violate the Anti-Deficiency Act. GAO addresses the specific areas of disagreement in chapter 2. (See pp. 15 to 17.)

DOD also stated that since the management of the family housing program has been devolved to the military services, they will be tasked to develop a tri-service manual providing the uniform guidance GAO recommends. GAO agrees with this approach and modified its recommendation on the need for uniform guidance to recognize the tri-service approach.

DOD comments are included in appendix II.

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ABBREVIATIONS

DOD	Department of Defense
FRG	Federal Republic of Germany
GAO	General Accounting Office

CHAPTER 1

INTRODUCTION

The primary goal of the Department of Defense (DOD) family housing program is to ensure that DOD personnel and their families have adequate, well-maintained housing. In its efforts to achieve this objective, DOD relies principally on the local housing market in communities near military installations. In Europe, however, the shortage of adequate housing with acceptable DOD standards of construction and features has required DOD to provide much of the needed housing.

As of September 30, 1983, the military services controlled over 77,000 housing units in Europe, and they reported future 5-year family housing shortages totaling over 35,000 units in their most recent surveys of local housing markets. This data was the most current information available at the completion of our field review in July 1984. Generally, the DOD-controlled housing in Europe was provided in several ways--leasing, military construction financed with U.S. government funds, and housing previously obtained from host nations.

Because the uncertain tenure of the U.S. Forces in Europe fostered reluctance on the part of the Congress and DOD to enter into extensive military construction of housing, DOD relied on leasing as a primary means of obtaining housing in the 1970s. The considerable growth of the foreign leasing program is demonstrated by the increase in the number of such leases between 1973 and 1983. In our 1973 report,[1] DOD considered 4,525 units as its ceiling for foreign leases. For fiscal year 1983, DOD was authorized to lease up to 29,000 foreign housing units at a maximum cost of $163.5 million, an increase of 24,475 units during the 10-year period. Of the 29,000 housing units, about 26,000 were in Europe. For fiscal year 1985, DOD was authorized to lease up to 30,000 units at a maximum cost of $196.5 million.

In recent years, congressional committees have expressed concern about the high cost of leases compared to the cost of military construction in foreign countries. In an August 11, 1982, report (House Report 97-726, 97th Cong., 2d Sess.), the House Committee on Appropriations indicated its concern about the steady increase in overseas leases and related costs compared to construction. The report stated that the Committee would not approve any new leases when the costs exceed the estimated costs of military construction. The Committee directed that cost-benefit analyses be performed for all new lease agreements

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[1]Comparative Costs of Alternative Methods of Providing Military Housing in Europe (B-166651, July 31, 1973).

covering over 10 units and that buy-out provisions be included in all new lease agreements when annual unit costs exceed $12,000. In a September 22, 1982, report (Senate Report 97-572, 97th Cong., 2d Sess.), the Senate Committee on Appropriations indicated that it supported the House Committee's position and believed strongly that, considering the rising costs of leases, lease agreements must be reviewed prior to any contractual obligation.

For fiscal years 1982 through 1984, the Congress authorized military construction funding of $232 million for over 2,500 family housing units in foreign countries. Over 2,100 of these units were designated for Europe. In addition, the military services were planning to request funds to finance the construction of over 9,400 units in Europe for fiscal years 1985 through 1989.

LEASING OF FAMILY HOUSING

Section 2828 of title 10 of the United States Code authorizes the secretaries of the military departments to lease family housing units in foreign countries. The statute contains various limitations on the authority provided to the departments, including:

--The maximum allowable lease period is 10 years.

--Annual rental expenditures for an individual family housing unit, including the costs of utilities, maintenance, and operation, may not exceed the maximum amount specified by law, which currently is $16,800.

--The number of foreign leased family housing units may not exceed the maximum specified by law, which currently is 30,000.

--Written notification must be made to the appropriate congressional committees 21 days before entering into any lease agreement having an average estimated annual rental exceeding the amount specified by law, which currently is $250,000.

The service secretaries have delegated the responsibility for acquiring leased family housing to their major commands. The specific commands responsible for managing leased family housing programs in Europe are Headquarters, U.S. Army, Europe, Federal Republic of Germany (FRG); the Naval Facilities Engineering Command's Atlantic Division, Norfolk, Virginia; and Headquarters, U.S. Air Forces, Europe, FRG.

Leasing includes direct leasing of existing units and build-to-lease agreements, which involve preconstruction agreements to build housing units specifically for leasing to the military. Since existing adequate housing is often not available for lease in Europe, the services rely primarily on build-to-lease agreements

to obtain housing. These agreements usually cover a period of 5 to 10 years and generally limit the lessors' financial risks by structuring the rents to allow the recoupment of all, or a substantial portion, of the projects' costs during the terms of the leases.

Although DOD was authorized to lease up to 29,000 foreign housing units for fiscal year 1983, the services had not completed lease awards for this total because negotiations were not complete or because suitable existing houses and build-to-lease lessors had not been found. As of September 30, 1983, the services had a total leased foreign housing inventory of 17,796 units. We could not obtain a breakdown of this total by country because DOD data was not readily available. However, according to available military services' data, the average number of leased foreign housing in fiscal year 1983 was 16,041 units, of which 14,483 or 90 percent, were located in Europe, as shown below.

Military Services' Average Leased Foreign Family Housing Units in Fiscal Year 1983[a]

Country	Army	Navy	Air Force	Total
Europe				
Federal Republic of Germany	8,181	-	1,790	9,971
Italy	517	1,065	5	1,587
United Kingdom	3	264	1,224	1,491
Spain	-	-	858	858
The Netherlands	133	-	190	323
Belgium	221	-	-	221
Turkey	3	-	21	24
Greece	1	1	5	7
Portugal	-	1	-	1
	9,059	1,331	4,093	14,483
Non-Europe:				
Korea	1,256	-	201	1,457
Philippines	-	51	-	51
Egypt	-	13	-	13
Indonesia	1	7	-	8
Tunisia	8	-	-	8
Malaysia	3	-	-	3
Other	7	3	8	18
	1,275	74	209	1,558
Total	10,334	1,405	4,302	16,041

[a] The services reported the total number of leased months for fiscal year 1983. The average number of leased foreign family housing units was obtained by dividing the total number of months by 12.

OBJECTIVE, SCOPE, AND METHODOLOGY

Our objective was to determine whether the military services were following sound procurement procedures and practices for awarding and administering leases. Although DOD and the services did not have regulations containing acquisition standards for foreign leases, we compared the service commands' lease procedures and practices with advertising, evaluating, and negotiating standards applicable to DOD contracts for supplies and services. We reviewed (1) solicitations of offers, (2) evaluation of offers and negotiations, (3) inclusion of buy-out provisions in leases, and (4) compliance with statutory limitations on leasing in foreign countries.

We did our fieldwork between May 1983 and July 1984 at the headquarters levels of DOD, Army, Navy, and Air Force, and the intermediate commands and selected installations (see app. I) responsible for managing the foreign lease program in Europe. We selected Europe because military installations in Europe accounted for about 26,000 of the total 29,000 foreign housing units authorized for leasing in fiscal year 1983.

Since the Air Force and Navy executed leases covering large numbers of family housing units, ranging from 100 to 400 units, and these services' lease files were maintained in one location in Europe, we were able to review a high percentage of leased family housing units in their fiscal year 1983 inventory. Our selection of each services' leases for review was done on a judgmental basis. We reviewed 35 lease agreements representing 4,240 housing units, or 82 percent of the Air Force inventory of 5,173 foreign leased units, as of September 30, 1983. For the Navy, we reviewed 15 leases representing 744 housing units, or 61 percent of the 1,228 foreign leased units.

The Army lease operations are spread throughout Europe, and the leases generally cover small numbers of family housing units. This results in a large number of leases. However, most of the Army's leased housing is acquired by eight leasing offices in the FRG.

To document leasing practices, we selected two of the eight Army leasing offices. The two offices maintained files for about 62 percent of the existing Army leased family housing units in the FRG, and 65 percent of all Army family housing units under lease negotiation. We reviewed 24 leases for 541 housing units, or about 5 percent of the Army's ending fiscal year 1983 inventory of 11,395 foreign leased units, and 58 leases that were under negotiation. Although we did not select the leases on a statistical sampling basis, we believe our review of Army leases indicates whether problems exist in procedures for awarding and administering leases because (1) the Army uses a standard format for lease

agreements in the FRG and (2) Army officials in Europe agreed that the lease operations at the offices visited were representative of other European locations.

Most of the selected leases involved payments in host country currencies. In determining the long-term rental and buy-out purchase prices for selected leases, we estimated the costs using projected currency exchange rates published in January 1984 by Chase Econometric Associates, Inc. We realize that projecting currency exchange rates over a period is contingent on many variables in foreign exchange markets; however, consideration of exchange rates is necessary to provide comparable cost data.

To obtain information about DOD's management of the leased family housing program, we reviewed pertinent statutes and their legislative histories; DOD and the military services' policies, regulations, and instructions on foreign leasing; internal audits; and DOD acquisition regulations. We also reviewed lease acquisition reports the services had submitted to congressional committees during fiscal years 1983 and 1984 to ascertain whether the services were complying with the statutory reporting requirements for leases with an estimated average annual rental exceeding $250,000. We interviewed various officials responsible for managing the program. Our review was made in accordance with generally accepted government auditing standards.

CHAPTER 2

IMPROVEMENTS NEEDED IN AWARDING AND ADMINISTERING LEASES

Section 2828 of title 10 of the United States Code contains reporting requirements and some general limitations on lease provisions that the military services must follow in leasing foreign family housing, such as the maximum lease period of 10 years and the limitation on expenditures for annual rental for a family housing unit. The statute, however, does not contain acquisition standards for advertising, evaluating, and negotiating foreign family housing leases. In addition, DOD regulations that cover procurements are not applicable to foreign leasing.

DOD has provided limited instructions to the services on the reporting requirements under section 2828. However, it has not issued guidance or required the services to develop formal and uniform procurement policies and procedures for foreign leasing that are consistent with the procurement principles contained in the DOD acquisition regulations. In the absence of such guidance, the services' major commands responsible for family housing in Europe have developed different acquisition procedures and practices for advertising, evaluating, and negotiating leases that are not fully consistent with procurement principles and to the best advantage of the United States. Problems found in one or more of the services' practices in awarding and administering foreign leases included:

--Inclusion of annual escalation clauses in build-to-lease agreements for net rental (rental excluding the cost of maintenance, operation, and utilities), which violate the Anti-Deficiency Act by obligating the United States to pay indeterminable or indefinite amounts of rental that could exceed the statutorily authorized maximum.

--Failure to advertise or prepare and issue formal solicitations for offers for leased family housing to ensure maximum competition.

--Inadequate consideration of some offers.

--Lack of cost or price analyses of build-to-lease agreements to ensure the United States obtains a fair rental price.

--Lack of documentation for the negotiations supporting the lease terms and conditions.

--Failure to prepare or use independent real estate appraisals in evaluating lessors' proposals for family housing units already built.

--Award of leases having annual rental cost exceeding $250,000, without submitting lease acquisition reports to the appropriate congressional committees.

NAVY'S USE OF RENTAL ESCALATION CLAUSES VIOLATES STATUTES

Our review of the leases disclosed that the Navy's lease agreements routinely included clauses for the annual escalation of the net rental while the other services' agreements seldom did. Twelve of the 15 Navy leases we reviewed provided for the annual escalation of net rental while only 3 of the 35 Air Force leases and none of the 24 Army leases provided for such escalation.

The Navy's practice of including escalation clauses for net rental is encouraged by inclusion of escalation clauses in solicitations sent to prospective offerors. For example, solicitations sent to prospective offerors for a build-to-lease project at West Ruislip, United Kingdom, contained a sample lease agreement with an escalation clause for the net rental. The Navy received five offers and all contained annual escalation clauses. The Navy eventually agreed to enter into a lease containing an escalation clause for 10 percent yearly increases of net rental over a 10-year period.

As structured in some lease agreements, the Navy's escalation clauses violate section 1341(a) of title 31 of the United States Code, known as the Anti-Deficiency Act, which prohibits U.S. officers and employees from subjecting the government to liabilities and expenditures in excess of those authorized by law. Section 1341(a) states:

"(a)(1) An officer or employee of the United States Government or of the District of Columbia government may not--

(A) make or authorize an expenditure or obligation exceeding an amount available in an appropriation or fund for the expenditure or obligation; or

(B) involve either government in a contract or obligation for the payment of money before an appropriation is made unless authorized by law."

Some Navy agreements violate the Anti-Deficiency Act because they obligate the United States to pay an indeterminate or indefinite amount of rental. Although other agreements do not currently violate the act, the amounts fixed for payments could, in the future, exceed the statutorily authorized maximum provided under section 2828(e) of title 10 of the United States Code. Section 2828(e) states that expenditures for the rental of a family housing unit in foreign countries, including the costs of utilities, maintenance, and operation, may not exceed the maximum amount specified by law, which currently is $16,800.

For six Navy build-to-lease agreements we found:

--Two leases in Italy provided for the annual escalation of net rental cost over 10-year periods based on indefinite increases in the Italian cost-of-living index, which fluctuates annually. As a result, the total cost over the lease periods is not known.

--Four leases in the United Kingdom provided for the annual escalation of net rental payments, ranging from 10 to 12 percent, over 10-year periods in British pound sterling and Swiss francs, for which exchange rates fluctuate with the dollar. Using projected exchange rates, we estimate two leases could exceed the current $16,800 statutory limitation in the eighth year and possibly sooner since maintenance and utility costs are required to be considered within the statutory limitation.

In a number of cases we have disapproved of agreements to make payments when the agreements would subject the United States to a contingent liability in an indefinite or indeterminate amount that could exceed relevant appropriations, thereby violating the Anti-Deficiency Act. Also, in a Comptroller General's decision of October 31, 1978 (58 Comp. Gen. 46), we noted that an agency is prohibited by the act from making payments in excess of funding limitations, notwithstanding that the limitations are exceeded to make contract payments because of fluctuations in currency exchange rates and not through the fault of the agency.

The Navy could have avoided the Anti-Deficiency Act conflict by structuring its lease agreements to include a clause providing that lease payments cannot exceed the amount of appropriations available at the time payments are due, and that nothing in the leases can be considered as implying the Congress would, at a later date, appropriate sufficient funds to meet deficiencies. The clause should also have specified that the maximum annual expenditures for rent, including the costs of utilities, maintenance, and operation, will not exceed the statutory ceiling established for such years under section 2828(e).

DOD AND THE SERVICES NEED TO IMPROVE PROCEDURES FOR ACQUIRING LEASED HOUSING

DOD has not issued guidance to the military services on what acquisition principles and procedures they must follow in awarding and administering foreign family housing leases. The services also have not developed acquisition procedures for their specific commands responsible for managing the housing programs in Europe. Since DOD and the services did not have regulations containing acquisition standards for foreign leases, we compared the service

commands' procedures and practices with the advertising, evaluating, and negotiating standards applicable to DOD contracts for supplies and services. The DOD regulations are contained in the Defense Acquisition Regulations for solicitations prior to April 1984 and the Federal Acquisition Regulation, with DOD supplement, for solicitations on or after April 1, 1984.

DOD regulations are primarily directed to the acquisition of supplies and services, and exclude land or interests in land, which includes leases of real property. According to DOD officials, the regulations were developed to prescribe uniform acquisition policies and procedures for supplies and services. Leasing is a conveyance of interests in land or real property, such as family housing, and is not covered by the regulations. However, because they provide direction on what provisions, clauses, and cost principles are authorized for contracts and what procedures DOD contracting personnel must follow in awarding and administering contracts, we believe many of their provisions could be adopted for foreign leasing to encourage competition and the acquisition of family housing to the best advantage of the United States.

The following weaknesses we noted in one or more of the commands' practices in awarding and administering foreign leases illustrate what can happen in the absence of DOD acquisition guidance for leasing.

Lack of advertising and competition

The DOD regulations pertaining to supplies and services favor advertising and competition by requiring that solicitations be sent to the maximum number of sources possible. The Army's major command in Europe did not require its real estate office to advertise for build-to-lease housing projects and the office did not seek to obtain competition for lease awards. As a result, many lease awards were based on unsolicited offers that lacked complete information for evaluation.

In 1957 the United States and the FRG signed an agreement that specifies that the FRG government will play a significant role in acquiring leased housing for U.S. forces. As implemented by the Army's major command in Europe, its real estate office notifies the FRG government of the number of housing units needed. The FRG government is responsible for obtaining offers and assisting the Army in screening the offers and in negotiations. The FRG government maintains lists of potential offerors, but it will not advertise in newspapers and other publications for prospective offerors unless the Army's real estate office specifically requests and funds the advertisements. The real estate office generally does not request the FRG government to advertise, and, unlike the Navy and Air Force, does not use solicitations for offers that would define minimum technical

requirements, deadlines for submission, and format for proposals. As a result, many lease offers are unsolicited and lack complete information for evaluation.

In reviewing 23 lease awards and 58 leases under negotiation, we found that only 12 lease files contained documentation showing the offers were submitted in response to advertisement or to letters requesting offers. An Army real estate office official told us that a substantial number of all offer submissions for family housing leases are unsolicited.

Inadequate consideration of offers

In three build-to-lease awards we reviewed, the Navy did not adequately consider some offers that had a reasonable chance of being selected for award. In all cases, a Navy technical evaluation board formally evaluated and ranked offer submissions and found at least two offers met the competitive factors in each lease solicitation. However, instead of promoting competition by conferring with all responsive offerors, Navy officials negotiated price and terms only with the offeror judged to be most advantageous. This practice is inconsistent with DOD regulations for supplies and services to ensure the government obtains the best contract agreements at reasonable cost by

--conducting written or oral discussions with all responsive offerors,

--advising offerors of deficiencies in their offers and affording them an opportunity to satisfy the government's requirements, and

--establishing a common cut-off date for discussions that allow offerors to submit their best and final offers.

Adequate cost analyses of build-to-lease agreements not prepared

We found that the Navy did not prepare adequate cost analyses of build-to-lease agreements to evaluate the reasonableness of prices before making awards. Build-to-lease agreements are generally structured so that the lessors limit their financial risk by recouping all, or a substantial portion, of the projects' construction and financing costs during the lease periods. Although Navy officials recognize this and solicitations for offers require the disclosure of estimated construction and financing costs, Navy negotiators do not analyze the information to determine the reasonableness of prices.

DOD regulations for supplies and services require contracting officers to make a cost or price analysis to determine whether the

offerors' prices are reasonable. This analysis involves evaluating cost or pricing data and proposed profit and determining that the proposed price represents what the contract should cost. Based on the analysis, contracting officers can negotiate reasonable prices.

For five build-to-lease agreements in Europe, we requested the Navy to provide us with cost analyses showing the estimated project cost, including construction, financing, and profit. Navy officials were unable to provide us with this information or to explain how many years it would take to amortize the lessors' construction and financing costs. One official stated that negotiators in Europe lack the necessary skills to make an in-depth analysis of project costs. The following cases illustrate what we found in reviewing the agreements for cost analyses.

--In March 1981, the Navy awarded a build-to-lease agreement for 205 housing units in Italy, covering a 10-year period. A cost analysis of the offeror's construction and financing costs and profit was not made prior to the negotiations and award. In February 1983, the Navy requested the Defense Contract Audit Agency to evaluate the lessor's cost of constructing the units. The audit agency reported that the lessor will not only recover its construction costs but also earn an estimated profit of 294 percent over the 10-year period.

--In January 1984, the Navy awarded a build-to-lease agreement for 200 housing units in Italy. Although the solicitations required potential offerors to submit income and cost statements, none of the offerors submitted complete information on costs and income. The Navy did not attempt to prepare cost analyses of the construction and financing costs or expected profits over the term of the lease award.

Negotiations not documented

The Navy's major command responsible for family housing in Europe requires the preparation and retention of documentation concerning the negotiations of lease terms to support the decisions made. This requirement is consistent with the DOD regulations for supplies and services, which require that a memorandum of negotiations disclosing the initial and revised prices be prepared at the conclusion of negotiations. However, the Air Force and Army do not require their negotiators to document the results of negotiations. For example, of 41 Army and Air Force lease files reviewed, only 16 files contained some form of negotiators' statements. Also, these statements did not always cite the lessors' initial price offers, the services' estimates, and the methods of resolving the differences to arrive at the final prices.

Real estate appraisals of existing houses not made

Of the three services reviewed, only the Army and Air Force required the use of real estate appraisals in negotiating fair and reasonable prices for family housing already built or nearing completion. However, we found that even though the Army and Air Force required real estate appraisals, the appraisals were not always made or completed before the award of leases for existing houses.

Air Force regulations provide that real estate appraisals be made when the annual costs of lease agreements are expected to exceed $25,000. Our review of 25 leases with annual costs exceeding $25,000 disclosed that 22 files did not contain these appraisals. According to an Air Force official, negotiators rely primarily on informal market surveys and their knowledge of local market conditions to determine whether offerors' prices are fair and reasonable.

The Army's policy provides that a real estate appraisal be made whenever annual rent is estimated to exceed $50,000. Our review of 19 leases with annual rental exceeding $50,000 disclosed that 4 files did not contain real estate appraisals. The appraisals in 6 other files were received after the negotiations had been completed.

REQUIRED CONGRESSIONAL COMMITTEES' REPORTS NOT SUBMITTED ON SOME LEASES

Section 2828(f) of title 10 of the United States Code requires the services to notify, at least 21 days before award, appropriate congressional committees of all proposed leases whose average estimated annual rental will exceed $250,000 over the term of the leases. The House Committee on Armed Services periodically holds hearings throughout the year on these leasing actions, and the Senate Committee on Armed Services and the House and Senate Committees on Appropriations also review the proposed actions.

DOD Instruction 4165.12, which interprets the requirement of this section states that the services must submit lease acquisition reports to the appropriate congressional committees and provides an acquisition report format to follow. These reports describe the number and location of housing units, justification for leasing, and estimated annual cost. However, the instruction does not describe when and how the $250,000 limitation applies to foreign leasing actions. As a result, the services' interpretations of reporting requirements are inconsistent and have resulted in awarding some high cost leases without the submission of reports to congressional committees. For example:

--The Navy submits acquisition reports to congressional committees whenever the rental cost of individual leases or groups of leases involving the same lessor exceeds the $250,000 statutory limitations. However, we reviewed four leases where a renewal option gave the United States the right to continue occupancy for a specified term and rental at the expiration of the initial lease period, and found that the Navy had exercised the options when the rentals exceeded the $250,000 limitation without submitting reports to congressional committees.

--The Air Force submits acquisition reports to congressional committees whenever individual lease rentals exceed the $250,000 limitation. However, it generally does not submit reports for groups of leases with the same lessor when rentals total more than the $250,000 limitation, even though use of the multiple leases was for the "convenience of the lessor." For example, we identified four cases where groups of leases with the same lessor covered family housing on the same street and for identical lease terms. In each case, the individual lease did not exceed the $250,000 statutory limitations, but the combined rental did.

In complying with congressional reporting requirements, the Army's submission of acquisition reports is based on the number of housing units needed to eliminate a current family housing shortage in a community, not on the number of units in proposed leases. In some cases, we noted that this practice resulted in submitting reports to congressional committees to lease more housing units in a community than the Army's headquarters command in Europe had authorized. To illustrate, in fiscal year 1983, the Stuttgart military community in the FRG submitted to congressional committees notification indicating its intent to lease 620 housing units even though the headquarters command in Europe had authorized only 411 housing units.

In commenting on a draft of this report, DOD stated that the Army's submission of acquisition reports covering the total community housing shortage was done to prevent any possibility of avoiding congressional notification requirements by leasing housing units in increments below the $250,000 limitation. Further, if a community received lease offers exceeding its authorization, the major command in Europe could readjust the community's authorization without exceeding the major command's total leased housing authorization.

CONCLUSIONS

Improvements are needed in the military services' procedures and practices for awarding and administering family housing leases in Europe. The acquisition practices of the services' major commands were not consistent with the procurement principles for advertising, evaluating, and negotiating that are reflected in DOD regulations for other types of procurements. Also, the commands' procedures were inconsistent in submitting lease acquisition reports to congressional committees.

The practices followed by the services resulted in (1) rental escalation clauses in Navy lease agreements that violate the Anti-Deficiency Act, (2) limited competition on Army lease awards, (3) inadequate consideration by the Navy of all lease offers, and (4) inconsistent interpretations of congressional committee reporting requirements for lease awards by each of the services.

The lack of DOD guidance for use in developing uniform lease acquisition regulations and the limited guidance for reporting have resulted in variation among the services' procedures and practices for awarding and administering leases. More importantly, the lack of guidance has resulted in procedures which are not consistent with acquisition principles, such as those applicable to procurement of supplies and services. DOD should issue uniform guidance on lease acquisition policies and procedures that (1) establish principles for advertising, evaluating, and negotiating, and (2) establish criteria for reporting to congressional committees.

RECOMMENDATIONS

To ensure that the military services follow consistent leasing procedures and practices and comply with congressional committee lease acquisition reporting requirements, we recommend that the Secretary of Defense direct the services to jointly develop and issue guidance on uniform policies and procedures for acquiring foreign leased family housing and for complying with the congressional committee reporting requirements for lease awards. This guidance should:

--Be consistent with those acquisition principles for advertising, evaluating, and negotiating contained in DOD regulations for other types of procurement.

--Require the services to provide, in leases having escalation of net rental clauses, that rental payments will not exceed the amount of appropriations available at the time payments are due or the statutory limit established for

such year under 10 U.S.C. 2828(e) and that nothing in the lease can be considered as implying the Congress would, at a later date, appropriate sufficient funds to meet deficiencies.

--Include congressional committee reporting requirements for lease awards on groups of leases with the same lessor and renewals of existing leases.

We further recommend that the Secretary of Defense direct the Navy to seek amendment to the Italian leases and any others that have been awarded containing provisions on escalation of rental in indefinite or indeterminate amounts. The leases should include clauses stating that rental payments will not exceed the amount of appropriations available at the time payments are due or the statutory limit established for such year under 10 U.S.C. 2828(e) and that nothing in the lease can be considered as implying the Congress would, at a later date, appropriate sufficient funds to meet deficiencies.

AGENCY COMMENTS AND OUR EVALUATION

DOD, in commenting on a draft of this report, generally concurred in our findings and conclusions and indicated it would take action to implement all of our recommendations. DOD stated that since completion of our field work the services had initiated various actions to ensure that the discrepancies we identified are overcome. A copy of the DOD comments is included as appendix II.

Our draft report suggested that DOD establish and issue guidance to the services for use in developing uniform policies and procedures for acquiring foreign leased family housing and for complying with related congressional committee reporting requirements. DOD stated that, in view of the devolvement of family housing management to the services, it would require them to develop a tri-service manual containing the needed guidance. We agree with this approach and have revised our recommendation to reflect our agreement.

The only disagreement expressed by DOD was with our conclusion that the Navy's use of rental escalation clauses in lease agreements violates the Anti-Deficiency Act. DOD stated that with respect to the leases containing escalation clauses in Italy, a Comptroller General's decision of June 14, 1979 (B-194353), appears to interpose no objection to the clauses. Further, DOD noted that 10 U.S.C. 2828 covering foreign leases is silent on the amount of the statutory limitation, which is prescribed annually by the military construction authorization acts, and believes that

the statutory limits would be adjusted in the future for inflation. It concluded that the Navy's leases with rental escalation clauses would fall under the Anti-Deficiency Act exemption provision "unless authorized by law" because 10 U.S.C. 2828 is silent on the amount of the statutory limit. However, DOD agreed that from a management standpoint, action should be taken to include in leases with rental escalation some form of "subject to appropriations" clause, and a clause specifying the maximum expenditure for rent, maintenance, utilities, and operations will not exceed the statutory limit established by the Congress.

The Anti-Deficiency Act prohibits agencies from making expenditures or incurring liabilities, including contractual liabilities, either in excess or in advance of appropriations. One of the reasons for the act's passage was to prevent coercive appropriations where the Congress was compelled to make appropriations because agencies had spent or obligated funds for which appropriations were insufficient.

In a number of cases, we have found contractual agreements violating the act when they subject the United States to an indefinite or indeterminate amount that could exceed appropriations. To remedy this problem, we have required clauses in contracts stating that (1) expenditures will not exceed available appropriations and (2) nothing in the contract may be considered as implying the Congress will, at a later date, appropriate funds sufficient to meet deficiencies. We believe that these considerations apply to those Navy long-term, build-to-lease agreements we reviewed where the rent payments are based on indefinite increases in the Italian cost-of-living index.

We, therefore, have added a recommendation to this report that the Navy seek to amend these leases and any others that have been awarded containing provisions on escalation of rental in indefinite or indeterminable amounts so that they will not be in violation of the act.

We do not agree that the Comptroller General decision referred to by DOD supports its position. In that decision, the Navy asked opinions on two specific questions concerning a yearly renewable lease in Italy. One question pertained to the interpretation of the lease rental escalation provision concerning the correctness of making advance rental payment adjustments based on overall Italian cost-of-living index instead of a more specific housing cost index. The other question concerned the legality of making annual advance payments. The Navy had prepared a voucher for an advance rental payment amounting to a 12-percent increase over the previous year's rent, based on the overall cost-of-living index.

The decision answered the specific questions, and the Navy did not mention nor request an opinion on whether the escalation clause would violate the Anti-Deficiency Act. The reason the act may not have been considered was that the lease was a year-to-year agreement where the Navy had an annual option to renew. At the time the Navy was ready to exercise the renewal option, presumably it would have been in a position to know how much rent was to be paid the following year. If the amount would have exceeded the statutory limitation, it could have terminated the lease.

Although 10 U.S.C. 2828 does not specify the dollar amount for the statutory limitation on expenditures, the section specifically states that the expenditures "may not exceed the amount specified by law as the maximum annual foreign family housing unit lease amount." That maximum has been fixed by law at $16,800 and has been that amount since fiscal year 1983.

We also believe DOD's expectation that the amount will be adjusted in the future for higher inflation should not be relied on to cover higher rentals resulting from the escalation clauses. As we previously suggested, attempts to coerce the Congress to set higher funding levels to cover rental payments conflict with the intention of the Anti-Deficiency Act. Moreover, the legislative history accompanying the Military Construction Codification Act (Public Law 97-214), which established the authorizations for the limits in section 2828, indicates the limits were not to be yearly changes. In their reports (House Report No. 97-612 and Senate Report No. 97-474, 97th Cong., 2nd Sess.) on the Military Construction Codification Act, the House and Senate Committees on Armed Services stated that while the amounts would be included in each military construction authorization act, changes would only be made when circumstances dictate a need for revision. The reports also indicate that the limit was established because of congressional concern with the high cost of foreign leases.

In regard to the Navy's leases with escalation clauses containing fixed amount of yearly increases, we have clarified our report to indicate these leases do not currently violate the Anti-Deficiency Act. However, such leases should contain the provisions we recommend in case future currency exchange rates would cause lease payments to exceed the $16,800 limitation, or any other statutory limitation fixed by law.

DOD also provided additional information on some of our findings and we have included it in the report where appropriate.

CHAPTER 3

ALTERNATIVES FOR REDUCING LONG-TERM LEASE COSTS

The House and Senate Committees on Armed Services and on Appropriations have expressed concern about the increasing cost of leases for foreign family housing. In recent years, they have advocated the use of other, less costly alternatives to meet family housing needs. These alternatives include the use of buy-out provisions that provide the United States with the option to purchase the leased housing during or at the conclusion of the lease, and the use of military construction funds to build new housing in foreign countries when leasing would be more costly.

In 1982, the Committees on Appropriations directed the services to include buy-out provisions in all new build-to-lease agreements having annual housing unit costs exceeding $12,000. Our review disclosed, as of April 1984, the Navy and Air Force had included these provisions in four leases and the Army had not included such provisions in its leases because none of its housing projects were expected to exceed the $12,000 unit costs. However, the services have different interpretations on the legal authority to enter into leases with these provisions and DOD guidance has not been provided on the best method to negotiate and structure the provisions.

Although military construction is an alternative to leasing, limited construction funds have been made available because of budgetary constraints, which are likely to continue. Military construction requires large initial outlays that have a sizeable impact in the current budget year. Leasing, on the other hand, has a short-term budgetary advantage because the total rent payments are not budgeted for in the first year. They are spread over the lease period and are budgeted annually.

The military services have reported future 5-year family housing shortages totaling over 35,000 units in Europe, and were planning to request military construction funds to finance over 9,400 units in Europe for fiscal years 1985 through 1989. Consequently, leasing is likely to remain an important method of providing future housing needs.

Because of budgetary constraints and the future family housing needs, we believe a suitable alternative funding mechanism would be the use of purchase contracts when economically justified. Unlike buy-out provisions, which provides the opportunity to purchase housing during or at the end of the lease period, purchase contracts would enable the services to decide in advance to buy the housing without the need for large single-year appropriations. The services would enter into agreements with contractors

for the construction and financing of the housing and make installment payments to them for interest and amortization of the project's costs. At the end of the contract period, title to the housing would vest with the United States, or host country in return for rent-free occupancy by military families.

CONGRESSIONAL COMMITTEE CONCERNS OVER HIGH COST OF LEASING

Congressional committees have expressed concern about the military family housing program because of the high cost of leasing and the lack of adequate housing at affordable prices for military families. In a September 1982 conference report (House Report No. 97-880, 97th Cong., 2d Sess.) on the fiscal year 1983 Military Construction Authorization Bill, the House and Senate Committees on Armed Services stated that every effort should be made to obtain the best possible housing in the most cost-effective manner. The committees noted that, for the first time in a decade, DOD had sought to build a substantial number of new foreign family housing in the FRG and United Kingdom. However, because of budgetary constraints and because it believed other approaches might be more cost-effective, the conferees deferred the FRG and United Kingdom projects.

Since then, other congressional committees' actions relating to military family housing have been taken. For example:

--Although legislation was not enacted, the House Committee on Appropriations, in its report on the fiscal year 1983 Military Construction Appropriation Bill, directed the military services to include buy-out provisions in all new build-to-lease agreements having annual housing unit costs exceeding $12,000. The Senate Committee on Appropriations indicated in its report that it supported this House position because of the rising costs of leases.

--For fiscal year 1984, the House and Senate Committees on Armed Services approved the construction of over 1,600 foreign family housing units. However, they stipulated in the Military Construction Authorization Act that at least 90 percent of the housing constructed in a foreign country must use manufactured or factory-built housing fabricated in the United States by U.S. contractors. The committees noted that this measure would ensure that U.S. contractors and materials would be involved and that the U.S. economy would benefit from the expenditure of funds for this housing.

BUY-OUT PROVISIONS INCLUDED IN LEASES

As of April 1984, the Navy and Air Force had included buy-out provisions in four build-to-lease agreements, and the Army had not included such provisions in its leases because none of its housing projects were expected to exceed the annual housing unit cost of $12,000. However, Army officials were attempting to develop an approach for structuring buy-out provisions in future leases.

In meeting the House Committee on Appropriations' direction on the use of buy-out provisions, the services have different interpretations on the extent of legal authority to enter into leases with these provisions and the best method to structure and negotiate them. These concerns have resulted in the Navy and Air Force adopting different approaches for negotiating the provisions.

Air Force approach

Build-to-lease agreements usually cover a period of 5 to 10 years and generally limit lessors' financial risks by structuring the rents to allow the recoupment of all, or a substantial portion, of the housing projects' costs during the terms of the leases. The Air Force structured its build-to-lease agreement buy-out provisions so that rental payments will amortize the family housing project total investment costs, which include construction, interest, and profit. When cumulative rental payments repay the total investment costs, the Air Force stops paying rent, as illustrated below.

--In October 1981 the Air Force awarded a build-to-lease agreement for 50 family housing units that would be constructed to its criteria on land owned by the Turkish government at Incirlik Air Base, Turkey. The lease contained buy-out provisions so that the rent payments over the 10-year period would fully amortize the lessor's investment costs. At the expiration of the lease term, the lessor would relinquish ownership to the government of Turkey, which would grant the Air Force continued occupancy at no rental cost under terms of the Defense Cooperation Agreement between Turkey and the United States. The lease also provided that the Air Force could prepay the total rental costs, including construction costs and interest incurred at the date of prepayment. In November 1982, the Air Force exercised the prepayment provisions with fiscal year 1983 military construction funds and estimated substantial savings by avoiding over $600,000 in interest costs, which would have been paid over the remaining lease term.

--The Air Force awarded a build-to-lease agreement in December 1982 for 800 family housing units that were to be constructed to its criteria on privately owned land near Torrejon Air Base, Spain. The buy-out provisions were structured so that rental payments over the 10-year term and subsequent renewal periods would be applied to the amortization of the lessor's investment costs. When the rental payments had completely amortized the project's total investment cost of about $62 million, the Air Force could have assumed title to the housing, with congressional approval, or could continue to lease on a direct cost basis. Another provision provided that the Air Force could prepay the investment costs, or the amount not amortized at the time of prepayment.

At the completion of our field work in July 1984, the Air Force's major command in Europe was proposing an amendment to the Torrejon Air Base lease. According to Air Force officials, the lessor was not able to borrow money from financial institutions to construct the housing under the lease terms. The amendment would have improved the lease's financial terms by increasing the amount of rental and total investment costs that would be amortized by the payments. The rent payments were described as amortizing the investment costs as if the payments were mortgage payments. The amendment would also have modified the buy-out provision by stipulating that if at any time during the initial 10-year period and the subsequent 10-year renewal period, the rent payments fully amortized the project's investment costs or a prepayment was made of costs not amortized, the Air Force could acquire the property. However, if the investment costs had not been amortized or prepaid over the 20 years, the Air Force would have to pay the fair market value to acquire the project.

In commenting on a draft of this report, DOD officials stated that the proposed amendment to the Torrejon Air Base lease never became a binding agreement because the Air Force terminated the build-to-lease agreement in October 1984. According to an Air Force headquarters official, the lessor was unable to comply with the agreement's prior conditions that it be able to obtain financing for the construction of the project.

Navy approach

The Navy's buy-out provisions will require the Navy to pay a purchase price reflecting the market price of the housing units at the time of purchase, even though rental payments have amortized a substantial part of the construction costs. The following illustrates what we found in reviewing the build-to-lease agreements.

In November 1981, the Navy awarded a build-to-lease agreement for 81 family housing units that would be constructed to its criteria on land owned by the United Kingdom's Ministry of Defense at West Ruislip. The lease contains a buy-out provision whereby the units can be purchased at escalated prices over the third to tenth year of the initial lease period. The rental payments also are subject to an escalation clause (see p. 7 for a discussion on use of rental escalation clauses). However, the rental payments are not applied to the amortization of the purchase prices in the lease. The lease provisions will require the United States to pay higher purchase prices over each year of the buy-out period, as shown in the following table.

Projected Cost[a] of Exercising West Ruislip, United Kingdom, Buy-out Provision

Year provision exercised	Cumulative rent	Purchase price	Total	Cost per unit
3	$1,508,965	$10,006,717	$11,515,682	$142,169
4	2,124,523	10,608,515	12,733,038	157,198
5	2,791,218	11,018,849	13,810,067	170,495
6	3,513,471	11,375,601	14,889,072	183,816
7	4,307,948	11,869,375	16,177,323	199,720
8	5,168,829	12,130,726	17,299,555	213,575
9	6,101,872	12,340,826	18,442,698	227,688
10	7,098,893	12,319,761	19,418,654	239,736

[a] To provide cost data for the escalated rent and purchase prices stated in British pound sterling, we used long-term projections for the British pound sterling and U.S. dollar exchange rates published by Chase Econometric Associates, Inc.

The other build-to-lease agreement contains similar buy-out provisions. In January 1984, the Navy awarded a lease for 200 family housing units that would be constructed to its criteria on privately owned land near the Naval Air Station, Sigonella, Italy. The buy-out provisions provide that the Navy can purchase the housing units on completion in November 1985, at an estimated construction cost of over $15 million, payable in Italian lire. The purchase prices in subsequent years are escalated by using the Italian cost-of-living index as are the rental payments, which are not applied to the amortization of the purchase prices. We estimate that if the Navy exercises the purchase provision at the end of the initial lease period, it will have paid over $19 million in rentals and would pay an additional purchase price of about $23 million for housing that cost $15 million to construct.

Buy-out approaches differ because of legal interpretations

The military services different negotiation approaches reflect their varying interpretations of the extent of their legal authority to buy out family housing property without congressional approval. Army and Navy officials in Europe believe that it may not be legal to buy out family housing property over a period of time using rental payments from appropriated operation and maintenance funds because the payments would violate existing laws. Moreover, Army officials believe that the use of rental payments to amortize a project's cost can be perceived as installment payments to the lessor to buy the property without congressional approval. However, Air Force officials in Europe believe that there are no statutory limitations to prevent them from using rental payments to amortize a project's cost if congressional approval is obtained to acquire title to the housing.

DOD has not provided the services guidance on negotiating buy-out provisions. According to DOD officials, DOD guidance on buy-out provisions is not needed because the services are responsible for managing their family housing programs. However, military service officials told us they believe DOD guidance is needed to clarify requirements for complying with the congressional direction and to determine what type of provisions would be beneficial to the United States.

The services' concerns stem from the various statutory provisions relating to limitations on the use of appropriated funds and to congressional approval to acquire real property. These provisions are highlighted below.

--10 U.S.C. 2828 allows the secretaries of the military departments to lease housing facilities in foreign countries for assignment as family housing to members of the armed forces. A lease may not exceed 10 years and the annual rental for a family housing unit cannot exceed the maximum amount specified by law, which currently is $16,800. There is no specific restriction on lease agreements with buy-out provisions. However, the section applies only to the rental of, not to the purchase of, housing.

--10 U.S.C 2676 prohibits the military departments from acquiring real property unless the acquisition is expressly authorized by law. The annual military construction appropriations acts which provide lease funds, contain a similar provision on family housing. The acts prohibit funds from being spent on land acquisition, site

preparation, or installation of utilities for any family housing except for housing in which funds have been made available in annual appropriations. These statutory limitations apparently require congressional authorizations for acquisition of family housing.

--10 U.S.C. 2677 authorizes the secretaries of the military departments to acquire options on parcels of real property before an acquisition is authorized by law if the property is considered suitable and likely to be needed for a military project.

--31 U.S.C. 1301 requires that appropriated funds only be spent for the purposes for which the funds have been appropriated.

There does not appear to be any specific prohibition on the military services' entering into build-to-lease agreements with buy-out provisions if the provisions are consistent with the limitations described above. However, the Air Force structured its buy-out provisions so that when rental payments amortize a project's cost, it can assume ownership with subsequent legislative approval by Congress. Moreover, the proposed amendment to the Torrejon Air Base agreement (see p. 21) would have required a prepayment before 20 years expired to prevent the Air Force from losing equity acquired through rental payments. Consequently, congressional approval would amount to a ratification of a purchase of family housing already paid for. This could require appropriation of additional funds to prevent the loss of any equity acquired by rental payments. We believe that this kind of arrangement can be perceived as exceeding the limitations in the law (10 U.S.C. 2676 and 31 U.S.C 1301).

The propriety of entering into leases that contain buy-out provisions similar to the Air Force's is complicated by recent congressional actions. The House Committee on Appropriations' direction to include buy-out provisions was contained in its report but not enacted into law. However, in the fiscal year 1984 Military Construction Authorization Act (Public Law 98-115), the Congress established a pilot program authorizing the military services to enter into leases for family housing units to be constructed on or near military installations in the United States whereby, at the end of the contract term, the United States would have the right of first refusal to acquire all right, title, and interest to the facilities. The act permits each service to enter into only two such contracts for periods up to 20 years and requires the Secretary of Defense to submit to the appropriate congressional committees economic analyses that demonstrate that the leasing would be more cost-effective than other alternative methods.

This restricted program for domestic build-to-lease agreements raises some question about the propriety of entering into build-to-lease agreements with buy-out provisions in foreign countries without specific legislative authority. Since the Congress has authorized a restricted program for U.S. build-to-lease agreements, similar legislation for foreign build-to-lease agreements would remove any ambiguity about their legal propriety.

Buy-out guidance needed

We found that DOD and the military services have not considered various alternatives, or combination of alternatives, to assist contracting officials in soliciting and negotiating buy-out provisions in leases. None of the services had made formal studies to (1) determine how other U.S. government agencies or private entities structure buy-out provisions, (2) identify changes needed in solicitations and negotiation procedures to assure that offerors understand the type of buy-out provisions that are acceptable, or (3) determine how the provisions should be considered in evaluating offers.

The Navy's lease at Sigonella, Italy, illustrates what can happen when adequate guidance is lacking. Although the solicitation stated that offerors should include buy-out provisions , it did not provide any guidance on how the provisions should be included and how they would be considered in evaluating the offer. None of the five offerors submitted a buy-out provision and they were not requested to revise their offers to include a buy-out provision. Navy officials selected a lessor with the understanding that they would later negotiate a provision. The lessor developed a buy-out provision that officials accepted without determining its reasonableness in terms of the project's costs, including construction and financing and rental payments. According to the Navy's chief negotiating official, the lessor was requested to develop the provision because of uncertainty over the type of buy-out provisions that should be included in the lease.

PURCHASE CONTRACT AUTHORITY OFFERS OPPORTUNITY TO REDUCE LONG-TERM LEASING COSTS

Granting the services purchase contract authority to buy family housing and enter into agreements with contractors for the construction and financing of the housing offers opportunity to reduce long-term leasing costs. The services would make installment payments to the contractors for interest and amortization of the project's costs. At the end of the contract period, title to the housing would vest with the United States, or host country in return for rent-free occupancy by military families. However, if this authority were granted, the services should prepare economic analyses comparing purchase contracting with other alternatives

(e.g., military construction) so that the relative costs of each alternative can be determined. In addition, the services need to ensure host country governments' support so that the purchase contract agreements could be exercised.

Purchase contracting

Although the term is not defined in a federal statute, in 1972, as a stop-gap measure to reduce the backlog of approved projects, the Congress granted the General Services Administration (GSA) 3-year authority to enter into purchase contracts for financing acquisition of buildings in the United States. Because of budgetary constraints and the limited funds available from the GSA building fund, its buildings construction program had not been adequately supported and leasing was primarily used to meet needs. Under Public Law 92-313, GSA borrowed $1.3 billion from private investors and the Federal Financing Bank to construct and acquire 68 buildings. Title to these buildings will be assumed by the government when the 30-year purchase contracts expire. Meanwhile, GSA makes periodic payments for principal, interest, and local real estate taxes.

The military services' build-to-lease agreements are a building program in foreign countries to obtain adequate housing for military families. Under these agreements, the lessors agree to construct housing and the services agree to lease that housing when constructed. Many times projects are located adjacent to military installations or in less populated locations having little or no demand for housing except by U.S. forces. These agreements usually cover a period of 5 to 10 years. According to DOD officials, the agreements generally limit lessors' financial risks by structuring the rent to allow the recoupment of all, or a substantial portion, of the housing projects' costs, including construction and financing, during the term of the leases, and result in rental payments substantially higher than prevailing rental rates. For example:

--If the Navy exercises the buy-out provisions at the end of the 10-year lease period for 200 housing units at Sigonella, Italy, we estimate that it will have paid over $19 million in rentals and pay an additional purchase price of about $23 million for housing costing $15 million to construct.

--The Defense Contract Audit Agency evaluated the lessor's cost of constructing 205 housing units for a build-to-lease agreement awarded in 1981 by the Navy in Italy, and reported that the lessor will not only recover its construction costs but also earn an estimated profit of 294 percent over the 10-year lease period.

Regardless of the higher rentals over the initial period, the services generally have only the right to renew for additional periods--in many cases at higher rental rates. If the services had purchase contract authority, they could stop making payments when the construction and financing costs have been fully amortized. We believe that this type of arrangement would be preferable to continuing to lease at higher rentals.

Economic analyses

The House Committee on Appropriations has expressed concern about the reliability of economic analyses comparing the costs of leasing with the costs of military construction of new housing. These analyses are required for all new leases for more than 10 housing units. In its report on the fiscal year 1985 Military Construction Appropriation Bill (House Report No. 98-850, 98th Cong., 2d Sess.), the Committee stated that

> "Current law requires that all lease proposals be analyzed for cost effectiveness prior to implementation. However, at this point the methodology used in performing these analyses vary widely among the Services. Factors such as currency fluctuations, inflation, buy-out provisions, discount rates, and rent escalation are handled differently among the Services despite the existing guidelines of both the Office of Management and Budget and the Office of the Secretary of Defense. For this reason the Committee directs the Office of the Secretary of Defense to develop and implement a consistent methodology for assessing the cost effectiveness of all future foreign lease agreements.***"

The Senate Committee on Appropriations agreed with the House Committee on the need for DOD to refine and implement consistent methodology in economic analyses.

Although purchase contracts offer certain benefits that make them a useful alternative to leasing, they may be more costly than the military construction of family housing. Therefore, before entering into purchase contract arrangements, the services should prepare economic analyses evaluating the comparative cost of purchase contracting with other alternative means of furnishing the same housing, including military construction. The results could be provided to the appropriate congressional committees considering the services' requests for approval of family housing acquisitions. The services should also use a consistent methodology in the economic analyses as directed by the committees on appropriations.

Host country support

An important consideration in purchase contracting would be assurance from a host country government that the United States would be able to acquire ownership of the housing or assign ownership to the host country in return for rent-free occupancy. When leasing foreign family housing, the military services must abide by host country laws and international agreements between the host country and the United States. International agreements and foreign policy considerations could prevent the services from exercising the same property rights as host country citizens and organizations and require consultation on real estate matters.

The military services have not obtained host country assurances that buy-out provisions could be exercised. Army officials and FRG officials were discussing what type of buy-out provision would be permitted. The Navy's lease at Sigonella, Italy, contains buy-out provisions permitting the United States to assume title to the housing units or assign title to the Italian government. However, Navy officials had not determined whether the Italian government would permit these ownership alternatives. The Air Force lease at Torrejon Air Base, Spain, would have allowed the United States to assume ownership once rental payments fully amortize the project's cost. However, Air Force officials did not know whether the Spanish government would allow the United States to own the family housing property.

The services' consultations with host country governments should clarify the residual value of family housing when the U.S. forces would no longer need the housing. For example, Air Force officials believe that the United Kingdom would permit the United States to sell the housing if the sales did not disrupt the local economy. We believe that residual value is an important consideration because of the financial benefits to the United States of reducing long-term costs.

CONCLUSIONS

The military services have taken different approaches in complying with the congressional committee direction to include buy-out provisions in leases because of the lack of clear statutory authority. This has resulted in different interpretations by the services over the legal authority to enter into buy-out provisions. Additional concerns are the best method to negotiate and structure the provisions for the financial benefit of the United States, and the need for assurances from host country governments that the provisions could be exercised. DOD needs to take a more active role to help the military services comply with congressional intent regarding buy-out provisions.

Another approach offering opportunities to reduce long-term leased housing costs would be legislation permitting the military services to enter into purchase contract arrangements for foreign family housing. Unlike buy-out provisions that provide the opportunity to purchase the housing during or at the end of the lease term, purchase contracting would enable the services to decide in advance to buy family housing without the need for large single-year appropriations for construction. The services would enter into agreements with contractors for the construction and financing of family housing. They would make installment payments to the contractors for interest and amortization of the project's costs. At the end of the contract period, title to the housing would vest with the United States, or host country in return for rent-free occupancy by military families.

If the Congress were to provide the military services with purchase contract authority, the services should prepare economic analyses comparing purchase contracting costs with those of leasing, leasing with buy-out provisions, and direct appropriation of construction funds for the needed housing. Further, they should obtain assurances from host country governments that the United States would be able to acquire ownership or assign ownership to the host country in return for rent-free occupancy.

RECOMMENDATIONS

To resolve the military services' concerns over the legal propriety of buy-out provisions, we recommend that the Secretary of Defense evaluate and propose legislation to the Congress on the type of buy-out provisions that should be permitted in foreign leases. The Secretary of Defense also should require the services to obtain assurances from host country governments that the United States would be able to exercise the buy-out provisions.

To provide the military services with another alternative method of acquiring needed housing in Europe, we recommend that the Secretary of Defense propose to the Congress specific legislation granting the military services authority to use purchase contracting, when appropriate.

If purchase contracting authority is granted by the Congress, we recommend that the Secretary of Defense require the military services to (1) prepare economic analyses comparing the costs of purchase contract arrangements with other alternatives and (2) seek host country governments' support before entering into purchase contracts.

AGENCY COMMENTS

DOD concurred with our findings and recommendations. (See app. II.) DOD said that it will prepare legislation for congressional consideration in the fiscal year 1987 budget submission on the type of buy-out provisions that should be permitted in new build-to-lease agreement, and the use of purchase contracting.

LIST OF COMMANDS AND INSTALLATIONS INCLUDED IN OUR REVIEW

Department of the Army

Chief of Engineers, Washington, D.C.
U.S. Army, Europe, Federal Republic of Germany
Headquarters, VII Corp, Federal Republic of Germany
U.S. Real Estate Agency, Frankfurt, Federal Republic of Germany
U.S. Real Estate Agency, Kaiserslautern, Federal Republic of Germany
U.S. Army Southern European Task Force, Vicenza, Italy

Department of the Navy

Naval Facilities Engineering Command, Washington, D.C.
Atlantic Division, Naval Facilities Engineering Command, Norfolk, Virginia
U.S. Navy, Europe, London, United Kingdom
European Branch of Atlantic Division, Naples, Italy
U.S. Naval Activities, London, United Kingdom
U.S. Naval Support Detachment, Holy Loch, United Kingdom
U.S. Naval Support Activity, Naples, Italy

Department of the Air Force

U.S. Air Forces, Europe, Federal Republic of Germany
Third Air Force, Mildenhall, United Kingdom
U.S. Air Force, Bentwaters, United Kingdom

APPENDIX II

THE ASSISTANT SECRETARY OF DEFENSE

WASHINGTON, D. C. 20301-4000

MANPOWER,
INSTALLATIONS
AND LOGISTICS

29 MAY 1985

Mr. Frank C. Conahan
Director, National Security and
International Affairs Division
U.S. General Accounting Office
441 G Street N.W.
Washington, D.C. 20548

Dear Mr. Conahan:

This is the Department of Defense (DoD) response to the General Accounting Office (GAO) draft report, "Leased Military Housing Costs in Europe Can Be Reduced by Improving Acquisition Practices and Using Purchase Contracts," dated April 26, 1985 (GAO Code No. 945521/OSD Case No. 6740).

The Department generally concurs with the report. Specific comments on each finding and recommendation contained in the report are provided in the enclosure.

Sincerely,

Lawrence J. Korb
Assistant Secretary of Defense
(Manpower, Installations & Logistics)

Enclosure

GAO note: Page references in this appendix have been changed to reflect their location in this final report.

GAO DRAFT REPORT - DATED APRIL 26, 1985
(GAO CODE NO. 945521) - OSD CASE NO. 6740

"LEASED MILITARY FAMILY HOUSING COSTS IN EUROPE CAN BE REDUCED BY IMPROVING ACQUISITION PRACTICES AND USING PURCHASE CONTRACTS"

SUMMARY OF FINDINGS AND RECOMMENDATIONS TO BE ADDRESSED IN DoD'S RESPONSE TO THE GAO DRAFT REPORT

* * * * *

FINDINGS

FINDING A : Congressional Committee Concern Over High Cost of Leasing -- Alternatives. The GAO noted that the DoD policy is to rely principally on communities near military installations as the source of family housing. The GAO, however, reported that in Europe, the shortage of adequate local housing meeting acceptable DoD standards has required DoD to provide much of the needed housing through leasing construction agreements. The GAO found that the rapid growth and high cost of leasing have caused significant congressional committee concern in recent years. The GAO further found that the House and Senate Committees on Armed Services have advocated the use of other, less costly alternatives to meet family housing needs, including the use of buy-out provisions (where annual costs exceed $12,000) that provide the United States with the option to purchase the leased housing during or at the conclusion of the lease, and the use of military construction funds to build new housing in foreign countries when leasing would be more costly. Because of budgetary constraints, and the future family housing needs, the GAO concluded that a suitable alternative funding mechanism would be the use of purchase contracts instead of build-to-lease agreements. GAO further concluded that the alternative would enable the Services to borrow construction funds without the need for large single year appropriations for construction. [See pp. i, ii, 18 and 19, and 28 and 29.]

DoD Position: Concur. The use of purchase contracting as a additional alternative to the existing build-to-lease options would be beneficial when economically justified.

FINDING B. Improvements Needed in Awarding and Administering Leases. The GAO noted the DoD regulations that cover procurements are not applicable to foreign leasing; however, the DoD has provided limited instructions to the Services on the reporting requirements of Section 2828, Title 10 of the U.S. Code. GAO found, however, that DoD has not issued guidance or required the Services to develop formal and uniform procurement policies and procedures for foreign leasing consistent with the procurement principals containded in the DoD acquisition regulations. The GAO further found

that in the absence of such guidance, the Service's major commands responsible for family housing in Europe have developed different acquisition procedures and practices for advertising, evaluating and negotiating leases that are not fully consistent with procurement principles and to the best advantage to the United States. For example, problems identified in one or more of the Services' practices in awarding and administrating foreign leases included: (1) failure to advertise or prepare and issue formal solicitations or offers for leased family housing to insure maximum competition, (2) inadequate consideration of some offers, (3) lack of supporting documentation for the negotations, and (4) failure to prepare or use independent real estate appraisals in evaluating lessors' proposals. The GAO concluded that, although DoD regulations are primarily directed to the acquisition of supplies and services and exclude land or interests in land, because they provide direction on what provisions, clauses and cost principals are authorized for contracts and what procedures DoD contracting personnel must follow in awarding and administering contracts, many of their provisions could be adopted for foreign leasing. The GAO further concluded that by doing this, competition could be encouraged and the acquisition of family housing to the best advantage of the U.S. could be better assured. [See pp. 6 and 8 to 12.]

DoD Position: Concur. Since the completion of field work by the GAO, the Services have instituted the revision of regulations to insure that the identified discrepencies are overcome. These cover the need for wider dissemination of properly formulated solicitations for bids, the necessity to fully consider all offers received and allow offerors opportunities to meet requirements, the necessity to have necessary documentation, such as cost analyses, during negotiations and the need for independent real estate appraisals where appropriate. Revisions will be complete by October 1985.

FINDING C: The Navy's Use of Rental Escalation Clauses Violates Statutes. GAO found that the Navy's lease agreements routinely include clauses for the annual escalation for the net rental while the other Services' agreements seldom did. GAO noted that the Navy's practice of including escalation clauses for net rental is encouraged by inclusion of escalation clauses in solicitations sent to prospective offerors. The GAO further found that, as structured in lease agreements, the Navy's escalation clauses violate Section 1341 (a), Title 31 of the U.S. Code, known as the

Anti-Deficiency Act, which prohibits U.S. officers and employees from subjecting the Government to liabilities and expenditures in excess of those authorized by law. GAO also found that some Navy agreements violated the Act because they obligated the U.S. to pay an indeterminate or indefinite amount of rental, while others violated the Act because the amounts fixed for payments could exceed the statutorily authorized maximum of $16,800 specified by law. GAO concluded that the Navy could have avoided the Anti-Deficiency Act conflict by structuring its lease agreements to include a clause providing that lease payments cannot exceed the amount of appropriation available at the time payments are due and that nothing in the leases can be considered as implying the Congress would, at a later date, appropriate sufficient funds to meet deficiencies. The GAO further concluded that the clause should have also specified that the maximum annual expenditures for rent, including the cost of utilities, maintenance and operation, will not exceed the statutory ceiling established. [See pp. 7 and 8.]

DoD Position: Partially Concur. DoD is not prepared to agree that the provisions in the lease agreements constitute violations of 31 U.S.C. 1341(a). With respect to the leases in Italy containing escalation clauses tied to the Italian Cost of Living Index, the Comptroller General, in an unpublished decision, B-194353, June 14, 1979, appears to interpose no objection to the provisions which apparently were reviewed in the draft report. With respect to the provisions of 10 U.S.C. 2828 which provides the authority for leasing housing units in foreign countries, the statute is silent concerning the amount of limitation on such leases. The amount of the limitation has been prescribed annually in the military construction authorization Acts. While the amount currently is $16,800, there is no reason to believe that the amount will not be adjusted to reflect inflation in the future. Because 10 U.S.C. 2828(c) is silent concerning the specific amount of lease limitations and because as the execution of such leases is otherwise authorized by 10 U.S.C. 2828, such leases fall within the provisions of the "unless otherwise authorized by law" provisions of 31 U.S.C. 1341(A).

While DoD is not prepared to agree that there are violations of the provisions of 31 U.S.C. 1341 concerning the Navy leases in question, DoD does agree that, from a management standpoint, it may be appropriate for some form of "subject to appropriations" clause and a statement that payments will not exceed statutory limitations to appear in the leases. Accordingly action is being taken to include a "subject to appropriation" clause in all future foreign leases. In addition, a clause specifying that the maximum expenditure for rent, maintenance, utilities and operations will not exceed the statutory ceiling established by Congress will be used in any case where escalation clauses are required. Action will be completed by October 1985.

FINDING D: Required Congressional Committees' Reports Not Submitted On Some Leases. GAO noted that the Services are required to notify appropriate Congressional Committees at least 21 days before award, of all the proposed leases whose average estimated annual rental will exceed $250,000 over the term of the leases. Although DoD Instruction 4165.12, which interprets this requirement, states that the Services must submit lease acquisition reports to the appropriate committees and provides an acquisition report format to follow, GAO found that the Instruction does not include a description of when and how the $250,000 limitation applies to foreign leasing actions. GAO further found that this results in inconsistent Service interpretations of the reporting requirements and has resulted in awarding some high cost leases without the submission of required congressional reports. For example the Army submits reports based on the number of housing units needed to eliminate a current family housing shortage in a community and not on the number of units in proposed leases, and in some cases this practice resulted in reports showing more leased units in a community than the Army headquarters command in Europe had authorized. GAO concluded that the lack of DoD guidance for use in developing uniform lease acquisition regulations and the limited guidance for reporting have resulted in variation among the Services. [See pp. 12 and 13.]

DoD Position: Concur. It should be noted however, that the Army's Title 10 proposals for the total community shortage was in response to Congressional direction not to lease units in increments to avoid Title 10 clearance requirements. The Army has now instructed U.S. Army Europe to not submit the Title 10 for the entire deficit unless not doing so would results in increments below the $250,000 reporting threshold and thus give the appearance of intent to avoid reporting requirements. Additionally, lease allocations provided for a "specific" community by the U.S. Army Europe are flexible based on changing deficits and can be readjusted within existing authorizations without exceeding the total Command authorizations. Guidance will be provided as indicated in response to Recommendation 1.

FINDING E: Buy-Out Provisions Included In Leases. The GAO found that, in response to 1982 congressional direction, the Navy and Air Force had included buy-out provisions in four build-to-lease agreements as of April 1984, but the Army had not included such provisions in its leases as none of its housing projects were expected to exceed $12,000; however, Army officials were attempting to develop an approach for structuring buy-out provisions in future leases. GAO also found that, because the Services have different interpretations of the extent of their legal authority to enter into these leases and the best method to structure and negotiate them, the Navy and the Air Force have adopted different approaches. For example, the Air Force approach to build-to-lease agreements usually covers a period of 5 to 10 years and generally limit financial risks by structuring the rents to allow the recoupment of all, or a substantial portion, of the housing project's cost during the terms of the leases. In the Navy's approach, buy-out provisions will require the Navy to pay a purchase price reflecting the market price of the housing units at the time of purchase even though rental payments have amortized a substantial part of the construction costs. The GAO concluded that the Services have taken different approaches in complying with the congressional committee direction to include buy-out provisions in leases because of the lack of clear statutory authority and this has resulted in different Service interpretations of the legal authority to enter into buy-out provisions. [See pp. 20 to 23 and 28.]

DoD position. Concur.

FINDING F: Buy-Out Guidance Needed. The GAO noted that Service officials stated that DoD guidance is needed to clarify requirements for complying with the congressional direction and to determine what type of provisions would be beneficial to the United States. The GAO found that the Services' concerns stem from various statutory provisions relating to limitations on the use of appropriated funds and to required congressional approval to acquire real property; however, there does not appear to be any specific prohibition on the Services entering into build-to-lease agreements with buy-out provisions if the provisions are consistent with the various limitations. GAO further found that (1) the Air Force

structured its buy-out provisions so that when rental payments amortize a projects' cost, it can assume ownership with subsequent legislative approval by the Congress, (2) the proposed amendment to the Torrejon Air Force agreement would require a prepayment before 20 years expired, consesquently congressional approval would amount to a ratification of a purchase of family housing already paid for, (3) this can be perceived as exceeding the limitations in the law, and (4) the propriety of entering into leases that contain buy-out provisions similar to the Air Forces' is complicated by recent congressional actions. The GAO also found that DoD has not considered various alternatives, or combination of alternatives, to assist contracting officials in soliciting and negotiating buy-out provisions in leases. The GAO concluded that since the Congress has authorized a restricted program for U.S. build-to-lease agreements similar legislation for foreign build-to-lease agreements would remove any ambiguity about their legal propriety. The GAO further concluded that OSD needs to take a more active role to help the Services comply with congressional intent regarding buy-out provisions. [See pp. 23 to 25 and 28.]

DoD Position: Concur. For clarification, the finding on the proposed amendment to the Torrejon Air Base agreement should be expanded to indicate that the agreement never became a binding agreement and has been dropped. Guidance on buy-out provisions will be provided in accordance with the response to Recommendation 1.

FINDING G: Purchase Contract Authority Offers The Services An Opportunity To Reduce Long-Term Leasing Costs. GAO found that granting the Services purchase contract authority to borrow construction funds and enter into agreements with contractors for the construction and financing of the housing offers an opportunity to reduce long-term leasing costs. The GAO reported that although the term purchase contracts is not defined in a Federal statute, in 1972, as a stop-gap measure to reduce the backlog of approved projects, the Congress granted the General Services Administration (GSA) 3-year authority to enter into purchase contracts for financing acquisition of buildings in the U.S. GAO noted that under this type of agreement, the Services would make installment payments to the contractors for interest and amortization of the projects' costs, and at the end of the contract period, title to the housing would vest with the U.S., or host country in return for rent-free occupancy by military families. GAO further found that an important consideration in purchase contracting is the assurance from a host country government that the United States would be able to acquire

ownership of the housing or assign ownership to the host country in return for rent free occupancy. The GAO concluded that if the Services had purchase contract authority they could stop making payments when the construction and financing costs have been fully amortized, which would be preferable to continuing to lease at higher rentals. GAO further concluded that if this authority were granted, the Services should prepare economic ananlyses comparing purchase contracting with other alternatives so that the relative costs of each alternative can be determined. The GAO also concluded that the Services should obtain assurances from host country governments regarding ownership rights. [See pp. 25 to 28.]

DoD Position: Concur.

RECOMMENDATIONS

RECOMMENDATION 1. The GAO recommended that the Secretary of Defense establish and issue guidance to the Services to use in developing uniform policies and procedures for acquiring foreign leased family housing and for complying with the congressional committee reporting requirements for lease awards. This guidance should: (1) be consistent with those acquisition principles for advertising, evaluating and negotiating contained in DoD regulations for other types of procurement, (2) require the Services to provide, in leases having escalation of net rental clauses, that rental payments will not exceed the amount of appropriations available at the time payments are due, or the statutory limit established for such year under 10 U.S.C. 2828(e) and that nothing in the lease can be considered as implying the Congress would, at a later date, appropriate sufficient funds to meet deficiencies, and (3) include congressional committee reporting requirements for lease awards on groups of leases with the same lessor and renewals of existing leases. [See pp. 14 and 15.]

DoD Position: Concur in the need for guidance for use in developing uniform policies and procedures for acquiring foreign leased family housing. As the management of family housing has been devolved to the Services, the proper vehicle for providing the required guidance is a tri-service manual. The Services will be tasked to institute the necessary action to develop the manual which will contain the guidance recommended by the GAO. This action will take approximately one year to complete.

RECOMMENDATION 2. The GAO recommended that the Secretary of Defense evaluate and propose legislation to Congress on the type of buy-out provisions that should be permitted in foreign leases. The Secretary of Defense also should require the Services to obtain assurances from host country governments that the United States would be able to exercise the buy-out provisions. [See p. 29.]

DoD Position. Concur. Legislation will be prepared for consideration in the FY 1987 law.

RECOMMENDATION 3. The GAO recommended that the Secretary of Defense propose to Congress specific legislation granting the Services authority to use purchase contracting, when appropriate. [See p. 29.]

DoD Position: Concur. Legislation will be prepared for consideration in the FY 1987 law.

RECOMMENDATION 4. The GAO recommended that, if purchasing contracting authority is granted by the Congress, the Secretary of Defense should require the Services to (1) prepare economic analyses comparing the costs of purchase contract arangements with other alternatives, (2) seek host country governments' support before entering into purchase contracts. [See p. 29.]

DoD Position: Concur.

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